

SEGA OF AMERICA, INC., Legal Department
Attorney-Client Communication
Privileged and Confidential

To: Tom Kalinske
From: Tom Klitgaard 
Subject: DIC- Lawsuit by Sega on Network Series
Date: September 25, 1995

cc: Paul Rioux
Shinobu Toyoda
Mike Ribero
Michealene Cristini Risley

Attached is a draft complaint against DIC on the network agreement. Michealene has had further discussions with DIC last week and needs until the end of this week to bring the negotiations to a conclusion, if possible.

The complaint is based upon the September, 1992, letter of intent (copy attached) for the network series and syndication series. Andy Heyward contends that the only agreements for the network series were an agreement dated October 29, 1991 (copy attached) and the September 1992 letter of intent. Sega claims that the 1991 agreement was terminated by the letter of intent, and that the parties did not thereafter ever reach a final agreement, thus leaving the letter of intent the operative document.

The letter of intent is very brief as to the network series. It simply provides that "A special has been already ordered by ABC and DIC shall continue to act as Sega's agent for the negotiation of a network weekly series. If an agreement is entered into with the network, DIC will have the exclusive right to produce the series."

The letter of intent provides that Sega shall retain ownership and copyrights of existing characters and any new characters or elements developed in "any" animation productions. However, it is unclear whether this retention of rights pertains to the network series, the syndication series, or both. Further, the same ambiguity exists as to (a) the obligations of the parties to refund all monies paid by Sega, less reasonable expenses incurred in production, distribution or promotion of the "series," and (b) the treatment of all work performed on the "series" as work made for hire and as the sole property of Sega, in the event the letter of intent is terminated.

The letter of intent provided that the parties would use their best efforts to negotiate in good faith to reach a mutual understanding concerning the terms of a formal agreement within 30 days of the date of execution. The complaint alleges that a final agreement was never executed and asks for a declaration of rights of the parties, together with an accounting by DIC of monies received by it as Sega's agent for the network series. The court would permit DIC to deduct its expenses as an agent, but these expenses would need to be audited as part of the court proceedings.

The complaint will probably not produce an immediate amount of substantial funds, apart from what may be recovered on the accounting (which is as yet undetermined). However, the complaint would seek to establish clearly Sega's exclusive right to revenues from the use of its copyrights and characters in broadcasts of the network programs on foreign television, reruns on domestic network television, and on cable programs. Additionally, the complaint would seek to establish Sega's exclusive rights to the music and the cels for the network programs. Finally, the complaint would seek to establish Sega's portion of the revenues from the home video sales and its rights and to its prevent sales of cels. Most importantly, the complaint would seek to protect Sega's copyrights and characters from use by DIC in any future network programming.

- - - - -

The Mitchell Silberberg firm, which prepared the complaint, estimates that the cost of the suit through trial would be in the range of \$475,000- \$781,000. I beleive this figure is too low, in view of the fact-intensive nature of the dispute. I would increase the estimate by roughly 50%, to \$900,000- \$1,200,000, depending upon the extent of discovery and the intensity with which DIC would defend.

I look forward to discussing the complaint and our strategy with you.

Attachments

- A. Draft Complaint for Declaratory Relief against DIC Enterprises.
- B. Letter Agreement dated September 23, 1992
- C. Letter Agreement dated October 29, 1991

MITCHELL, SILBERBERG & KNUPP
ROY L. SHULTS (SB # 58297)
11377 West Olympic Boulevard
Los Angeles, California 90064-1683
(310) 312-2000

Attorneys for Plaintiff
Sega of America, Inc.

DRAFT

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

SEGA OF AMERICA, INC.,

Plaintiff,

v.

DIC ENTERPRISES, INC. and DOES 1
through 10, inclusive,

Defendants.

CASE NO.

COMPLAINT FOR DECLARATORY
RELIEF, BREACH OF FIDUCIARY
DUTY, VIOLATIONS OF CALIFORNIA
BUSINESS AND PROFESSIONS CODE
§17200, CONVERSION, AND AN
ACCOUNTING AND IMPOSITION OF
A CONSTRUCTIVE TRUST

Plaintiff Sega of America, Inc. ("Sega") alleges:

ALLEGATIONS COMMON TO ALL CAUSES OF ACTION

1. Sega is a corporation incorporated in the State of California, with its principal place of business in Redwood City in the County of San Francisco, California.

2. Sega is informed and believes, and upon such information and belief alleges, that defendant DIC Enterprises, Inc. ("DIC") is a corporation incorporated in the State of California, and is a wholly-owned subsidiary of DIC Animation City, Inc. DIC has its principal place of business in the City of Burbank, County of Los Angeles, California.



3. Sega is presently unaware of the identities of Defendants sued as Does 1 through 10, and thereby sues said Defendants by such fictitious names. Sega will seek leave of court to amend this complaint to set forth their true identities when ascertained. Sega is informed and believes, and upon such information and belief alleges, that said Defendants were actively involved in or participated in the actions hereinafter alleged, and are liable to Sega therefor.

4. On or about October 29, 1991, Sega and DIC Animation City, Inc. entered into a written agreement (the "1991 Agreement") pursuant to which DIC proposed to acquire from Sega certain rights to produce, distribute and exploit live action and animated television programming based upon Sega's video game program "Sonic the Hedgehog". A true and correct copy of the 1991 Agreement is attached hereto marked Exhibit A, and is incorporated herein by reference.

5. Under the 1991 Agreement, if DIC failed to obtain a network commitment or syndication order by May 1, 1992, the 1991 Agreement became terminable by either party. DIC in fact failed to obtain a network commitment or syndication order by May 1, 1992, at which time the 1991 Agreement became terminable.

6. On or about September 24, 1992, Sega, DIC, and another entity, Bohbot Communications, Inc. entered into a new agreement (the "1992 Agreement") which superseded the 1991 Agreement. A true and correct copy of the 1992 Agreement is attached hereto marked Exhibit B, and is incorporated herein by reference.

7. The 1992 Agreement contemplated that the parties would use their best efforts and "negotiate in good faith to reach a mutual understanding concerning the terms of the formal agreement within 30 days of the date on which all parties execute this letter." Exh. B, Page Four. Following the execution of the 1992 Agreement, the

1 parties in fact entered into prolonged negotiations over several years to that end, which
2 negotiations were unsuccessful. [The last complete version of a draft formal agreement
3 was prepared by counsel for Sega as of September 21, 1994 ("1994 Draft"). A true and
4 correct copy of the 1994 Draft is attached hereto marked Exhibit C.]

5
6 8. Notwithstanding that the parties never signed a more formal or different
7 agreement following the execution of the 1992 Agreement, DIC proceeded to produce 26
8 episodes of the Network Series, comprising the pilot and 25 subsequent episodes, which
9 episodes have been broadcast on the ABC television network.

10
11 9. On or about July 20, 1995, DIC's President, Andy Heyward, confirmed in
12 writing in a letter directed to Sega that the only agreements that had ever existed
13 between Sega and DIC in DIC's view were the 1991 Agreement and the 1992
14 Agreement. [A true and correct copy of that letter is attached hereto marked Exhibit
15 D. Further recognizing that Sega and DIC had failed to reach any agreement
16 superseding the 1992 Agreement, on September 6, 1995, DIC's counsel directed a
17 letter to counsel for Sega proposing still further negotiations on a range of issues
18 relating, inter alia, to the Network Series. A true and correct copy of that letter is
19 attached hereto marked Exhibit E.]

20
21 10. Under the 1992 Agreement, Sega retains "all ownership and copyrights in
22 existing characters and any new characters or elements created for any animation
23 productions. In addition, Sega shall have the right to use any animation produced in
24 future version (sic) of its video games on a royalty-free basis." Exhibit B, Page Two.

25
26 11. Under and by virtue of the 1992 Agreement, DIC was to act as Sega's
27 agent for the negotiation of a network weekly series (hereinafter the "Network Series"),
28 and in the event an agreement was entered into with ABC, DIC was to have the

1 exclusive right to produce the series. Exhibit B, Page One. As Sega's agent, and by
2 reason of the trust and confidence that Sega thereby reposed in DIC and that DIC
3 assumed from Sega, DIC had and maintained at all times mentioned herein a fiduciary
4 relationship with Sega.
5

6 12. Sega is informed and believes, and upon such information and belief
7 alleges, that at the time it was acting as Sega's agent and fiduciary in negotiations with
8 ABC, 80% of the stock of DIC had been acquired or was in the process of being
9 acquired by ABC. Sega is further informed and believes, and upon such information
10 and belief alleges, that DIC ultimately entered into a network licensing agreement with
11 ABC pursuant to which DIC would produce and ABC would broadcast the Network
12 Series, and in so doing had a duty not only to negotiate at arms length with ABC but
13 to act in Sega's best interests. Sega is informed and believes, and upon such
14 information and belief alleges, that notwithstanding the foregoing, DIC failed to act in
15 Sega's best interests because, among other reasons, DIC has at all times mentioned
16 herein failed and refused to account to Sega with respect to the expenses incurred in
17 producing or distributing the Network Series and with respect to any and all monies
18 obtained or received by DIC in connection with the Network Series.
19

20 FIRST CAUSE OF ACTION FOR DECLARATORY RELIEF
21

22 13. Sega incorporates by reference as though fully set forth hereunder the
23 allegations of paragraphs 1 through 11 inclusive hereof.
24

25 14. An actual controversy has arisen and now exists between Sega and DIC in
26 that Sega contends that:
27
28

1 A. The 1991 Agreement expired according to its terms, and by virtue of
2 their execution of the 1992 Agreement, DIC and Sega effected a novation, intending to
3 extinguish any obligations that may have existed between them under the 1991
4 Agreement and substituting for any such old obligations the new obligations created by
5 the 1992 Agreement.

6
7 B. The 1992 Agreement is subject to termination by Sega at this time
8 for the following independent reasons, among others:

9
10 (i) the parties have failed to reach agreement on material terms
11 and conditions of any different or more formal agreement between and among them;

12
13 (ii) DIC has violated its fiduciary duties to Sega; and

14
15 (iii) DIC has otherwise breached the 1992 Agreement.

16
17 C. As of the filing of this complaint and consequent termination of the
18 1992 Agreement by Sega, DIC has no rights whatsoever with respect to further
19 production, distribution, or exploitation of the Network Series, all rights in or to which,
20 including but not limited to all ownership and copyrights in existing characters and any
21 new characters or elements created for any animation productions by DIC, belong
22 solely and exclusively to Sega;

23
24 D. As Sega's agent, DIC is obliged to account to Sega for all monies
25 purportedly expended or received by DIC heretofore and hereafter in connection with
26 the Network Series.

27
28 15. DIC disputes some or all of Sega's contentions.

16. A declaration by the court is necessary at this time because DIC and Sega have been unable to agree with respect to the matters in controversy, and in order to avoid a continuing and accelerating dispute across a multiplicity of issues, likely to produce a multiplicity of actions. Sega has no other plain, speedy or adequate remedy at law.

SECOND CAUSE OF ACTION FOR BREACH OF FIDUCIARY DUTY

17. Sega incorporates herein by reference as though fully set forth hereunder the allegations of paragraphs 1 through 11 inclusive hereof.

18. The actions of DIC alleged above constitute breaches of the fiduciary duty owed by DIC to Sega.

19. As a direct and proximate result of DIC's breaches of its fiduciary duty to Sega, Sega has suffered damages in an amount not now known, but which exceeds the jurisdictional limit of this court. Sega will seek leave of court to amend its complaint to set forth the exact amount when ascertained.

20. In doing the aforementioned acts, DIC was guilty of malice, fraud, and oppression. By reason thereof, Sega is entitled to recover from DIC in addition to its actual damages, damages for the sake of example and by way of punishing DIC in an amount according to proof.

21. Unless preliminarily and permanently enjoined from so doing, DIC will continue to exercise or to purport to exercise rights with respect to the production, distribution, marketing and other exploitation of the Network Series, its artwork, characters and other elements, and cels and other items embodying the foregoing, all of

1 which rights belong to Sega. Sega has no remedy at law adequate to address DIC's
2 actions, and while DIC's actions have caused, are causing and will continue to cause
3 injury to Sega, its damages are irreparable, irremediable, and not calculable in monetary
4 terms.

THIRD CAUSE OF ACTION FOR VIOLATIONS OF

CALIFORNIA BUSINESS AND PROFESSIONS CODE §17200 ET SEQ.

22. Sega incorporates herein by reference as though fully set forth hereunder
10 the allegations of paragraphs 1 through 11 inclusive hereof.

23. The acts of DIC alleged above constitute unfair competition and unfair
13 acts and practices prohibited by California Business & Professions Code §17200.

24. Sega is informed and believes, and upon such information and belief
15 alleges, that as a direct and proximate result of its unfair competition alleged above,

17 DIC has received and will receive money, property and other benefits that rightfully
18 belong to Sega, and Sega is entitled to appropriate orders of this court restoring all such
19 money, property and other benefits to Sega.

25. DIC's continuing acts and conduct are causing and threaten to continue to
21 cause Sega irreparable and irremediable injury not readily calculable in money

23 damages, and by reason thereof Sega is entitled to an order preliminarily and

24 permanently enjoining DIC from engaging in such acts and conduct, as prayed for

25 below.

28

27

26

25

24

23

22

21

20

19

18

17

16

15

14

13

12

11

10

9

8

7

6

5

4

3

2

1

FOURTH CAUSE OF ACTION FOR CONVERSION

26. Sega incorporates herein by reference as though fully set forth hereunder the allegations of paragraphs 1 through 11 inclusive hereof.

27. At all times herein mentioned since their creation, Sega was, and still is, the owner, and was, and still is, entitled to the possession of the following personal property, namely the original cels created in the course of production of the Network Series;

28. Sega is informed and believes, and upon such information and belief alleges, that in or about January, 1994, the cels created in the course of production of the Network Series were delivered to DIC.

29. Sega is informed and believes that at the time the cels were delivered to DIC, they had varying values in the resale market, in amounts not presently known to Sega. Sega will seek leave of the court to set forth the exact values when ascertained.

29. Sega is informed and believes, and upon such information and belief alleges, that commencing in or about January, 1994 and continuing thereafter, without Sega's consent, DIC has sold a number of the Network Series cels, and is continuing to sell Network Series cels, to persons and entities the identities of whom or which are presently unknown to Sega, and thereby converted those Network Series cels and the proceeds of their sale to its own use.

30. Between the time of DIC's conversion of the Network Series cels and the commencement of this action, Sega and its employees and attorneys have properly expended substantial time and money in pursuit of the converted cels, all to Sega's

1 further damage in an amount not yet ascertained. Sega will seek leave of court to
2 amend this complaint to set forth the exact sum when ascertained.
3

4 31. In doing the aforementioned acts, DIC was guilty of malice, fraud, and
5 oppression. By reason thereof, Sega is entitled to recover from DIC in addition to its
6 actual damages, damages for the sake of example and by way of punishing DIC in an
7 amount according to proof.
8

9 **FOURTH CAUSE OF ACTION FOR ACCOUNTING**
10 **AND IMPOSITION OF A CONSTRUCTIVE TRUST**
11

12 32. Sega incorporates herein by reference as though fully set forth hereunder
13 the allegations of paragraphs 1 through 11, 17, and 25 through 28 inclusive hereof.
14

15 33. In addition to the foregoing, between the date of execution of the 1992
16 Agreement and the commencement of this action, DIC has collected monies under and
17 by virtue of that agreement, the amount of which is not known to Sega.
18

19 34. On an accounting by DIC, there will be found a balance due to Sega, the
20 amount of which is not known to Sega. An accounting by DIC is necessary to show
21 and would in fact show that amount.
22

23 35. Prior to the commencement of this action, Sega demanded an accounting
24 for DIC's expenses and revenues in connection with DIC's actions pursuant to the 1992
25 Agreement. DIC has never rendered such an accounting to Sega, nor paid to Sega any
26 money DIC was obligated to pay to Sega thereunder.
27
28

36. By virtue of DIC's violation of the relationship of trust and confidence that has existed at all times mentioned herein by reason of DIC's status as Sega's agent under the 1992 Agreement, DIC holds all money, property and other benefits it has received or may hereafter receive under, in connection with, as a result of or arising from the 1992 Agreement as a constructive trustee for Sega's benefit.

WHEREFORE, Sega prays:

1. Under its First Cause of Action, for an order declaring that its contentions are correct;

2. Under its Second and Fourth Causes of Action, for its actual damages, according to proof;

3. Under its Third Cause of Action, for restitution in an amount according to proof;

4. Under its Second, Third, Fourth and Fifth Causes of Action, for an accounting of all monies owing to Sega;

5. Under its Second, Third, Fourth and Fifth Causes of Action, for an order declaring that DIC holds all money, property and other benefits it has received under, in connection with, as a result of or arising from the 1992 Agreement in trust for Sega;

6. Under its Fourth Cause of Action, for its costs, including attorneys' fees, expended in pursuit of the Network Series cels;

1 7. Under its Fourth Cause of Action, for punitive damages in an amount
2 according to proof at trial;
3

4 8. Under its Second and Third Causes of Action, for a preliminary and
5 permanent injunction enjoining DIC and all those acting in concert or participating
6 with DIC from:
7

8 A. Taking any action to produce any additional episodes of the
9 Network Series;
10

11 B. Granting or purporting to grant any rights with respect to the
12 Network Series or any character or element therein, including but not limited to any
13 rights to air the Network Series on cable television, whether on the USA Network or
14 otherwise;
15

16 C. Distributing or attempting to distribute the Network Series in any
17 media worldwide, including but not limited to non-U.S. television and home video
18 markets;
19

20 D. Retaining or selling any original cels from the Network Series; or
21

22 E. Asserting to any other person or entity, aside from pleadings in a
23 legal action, that it has any right, title and ownership in and to any characters or
24 elements in the Network Series, including but not limited to any new characters or
25 elements created by DIC in connection with the production of the Network Series;
26

27 9. For its costs of suit incurred herein; and
28

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

10. For such other and further relief as the court deems appropriate.

Dated: September __, 1995

MITCHELL, SILBERBERG & KNUPP
ROY L. SHULTS

DRAFT

By _____
Roy L. Shults

Attorneys for Plaintiff
Sega of America, Inc.

RLS_P001.REV